"THE INTEREST EQUALIZATION TAX EXTENSION ACT OF 1967" (H.R. 6098)

SUMMARY OF PROVISIONS OF H.R. 6098, AS PASSED BY THE U.S. HOUSE OF REPRESENTATIVES

PREPARED FOR THE USE OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

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SUMMARY OF H.R. 6098 "THE INTEREST EQUALIZATION TAX EXTENSION ACT OF 1967"

I. THE TAX IN GENERAL

The interest equalization tax is a part of the balance-of-payments program and, as such, is designed to lessen foreign demands for U.S. capital. The design of the tax is to raise the costs to foreigners of obtaining capital in the United States to levels which approximate the costs of raising the capital in their own countries.

The tax is imposed on U.S. persons which acquire foreign securities and foreign debt obligations at rates which are roughly equivalent to a 1-percent increase in the rate of interest foreigners have to pay to obtain funds here. Under present law, the tax is imposed at the rate of 15 percent in the case of stock. A sliding scale of rates is prescribed for debt obligations, ranging from 1.05 percent for obligations with a maturity of 1 year to 15 percent for obligations with maturities of 28½ years or more. A tax rate of 15 percent on an obligation with a maturity of 28½ years is approximately equal to the present value of a 1 percent per year interest charge on the obligation. The lower tax rates for obligations with shorter lives achieve substantially the same effect. It is expected that the tax, although imposed on the buyer or lender, generally is passed on to the seller or borrower as an additional cost which must be recovered to make the loan attractive to the buyer or lender.

II. THE HOUSE BILL

a. Extension of the tax and authority to vary rates

Under present law the interest equalization tax terminates as of July 31, 1967. H.R. 6098 extends the tax for 2 more years, or until July 31, 1969.

H.R. 6098 also provides discretionary authority for the President to vary the tax within a range represented by the present rates and rates 50 percent higher. This discretionary authority enables the President to vary the tax between the present rates, which range up to 15 percent, and a set of rates 50 percent higher, which range up to 22.5 percent. These rates are designed to enable the President to increase the interest cost equivalent for foreigners borrowing funds in this country from a 1 percent per annum equivalent up to 1½ percent per annum. For the President to exercise this discretionary authority, he must find that it is necessary in order to carry out national balance-of-payments objectives.

During the interim period from January 26, 1967 (the day after H.R. 3813, the administration proposal and the earlier version of this bill, was introduced in the House) until 30 days after the date of enactment of this bill, the higher rates—those equivalent to a 1½ percent per annum interest cost—are to be applicable without discretionary action on the part of the President. At the end of that period, however, the rates are to automatically revert to the interest

equivalent of 1 percentage point unless the President exercises his authority to raise the rates above that level. The higher interim rates are provided to forestall buying of foreign stocks and debt obligations in anticipation of an increase in the rates of tax.

b. Other modifications in existing provisions of the interest equalization tax

H.R. 6098 also makes the following additional modifications in the present provisions of the interest equalization tax:

(1) Under present law, an American who sells foreign real property is subject to the tax to the extent the American provides the foreign purchaser with financing for the property for more than 1 year, unless the property has been held for the American's personal use (such as a residence). The bill extends this exemption to any debt obligations acquired by an American in connection with the sale of real property located outside the United States if the American seller owned the foreign real property on July 18, 1963 (i.e., before the initiation of the interest equalization tax).

(2) Present law provides that aliens present in the United States become subject to the interest equalization tax as soon as they acquire the status of a U.S. "resident." The bill provides an exception from the tax with respect to stock or debt obligations acquired by a foreigner who is a "resident" if the acquisition is made during the 90-day period beginning on the date the foreigner first became a U.S. resident. Where a foreigner acquires foreign securities during his first 90 days of U.S. residency and does not pay the tax, the bill provides that if he subsequently sells these securities to other Americans the tax is to apply to these sales.

(3) Present law provides an exemption from the interest equalization tax for debt obligations acquired in connection with the sale of ores or minerals obtained by U.S. persons under a contract entered into before the initiation of the interest equalization tax. The bill extends this exemption to also cover substitutes for these earlier contracts so long as the substitutes were entered into before January 26, 1967. The debt obligations exempted in these cases may not exceed the amount of the debt obligations which could have been acquired under the earlier contracts.

(4) In connection with the present monetary stabilization exclusion from the interest equalization tax for newly issued Canadian stock or debt obligations, present law provides a limited penalty for the failure to file information on time concerning purchases of such securities. The penalty is 5 percent for each month the notice is late, of what the tax would be were there no exclusion, up to a maximum of 25 percent. This limited penalty presently applies, however, only to acquisitions from October 10, 1965, onward; for periods before that time, late filing resulted in the complete loss of the exemption. The bill extends the 5 to 25 percent penalty applicable since October 9, 1965, to the period from the initiation of the interest equalization tax to October 9, 1965. The bill also provides that State governments which have made acquisitions of Canadian stock or debt obligations are to have a period of 60 days after the enactment of the bill in which to file the required notice concerning their past acquisitions. Those which do so are not to be subjected to the tax for failing to file notices on time.

(5) Under present law, U.S. dealers in foreign debt obligations may acquire these obligations without payment of tax (through a credit or

refund) if: (a) they resell to foreigners within 90 days after purchase, or (b) they resell within 90 days to another U.S. dealer who resells within the same or the next business day to foreigners. In the case of debt obligations acquired by a U.S. dealer and sold to a second U.S. dealer, the bill provides that the acquisitions are to be free of tax if the second dealer resells to foreigners within 30 days (instead of within 1 day) from the date of purchase.

(6) Present law provides an exemption from the tax for foreign branches of U.S. banks which make loans to foreign persons with funds obtained abroad. The bill provides a similar exemption for small finance companies. Thus, under the bill, a U.S. corporation engaged in the small loan and finance business outside the United States, which makes loans to the general public with funds acquired abroad, may elect to be exempt from the interest equalization tax.

(7) The bill also provides that a U.S. corporation primarily engaged in the business of borrowing funds abroad and using those funds to finance sales by affiliated domestic companies of property or services to foreign persons, may elect to be exempt from the tax on the debt obligations it acquires as a result of these financing activities. The financing company may only make loans, however, in connection with those sales where 15 percent of the property or services sold consists of U.S. property or services of U.S. persons.

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